DOW THEORY LETTERS INC.

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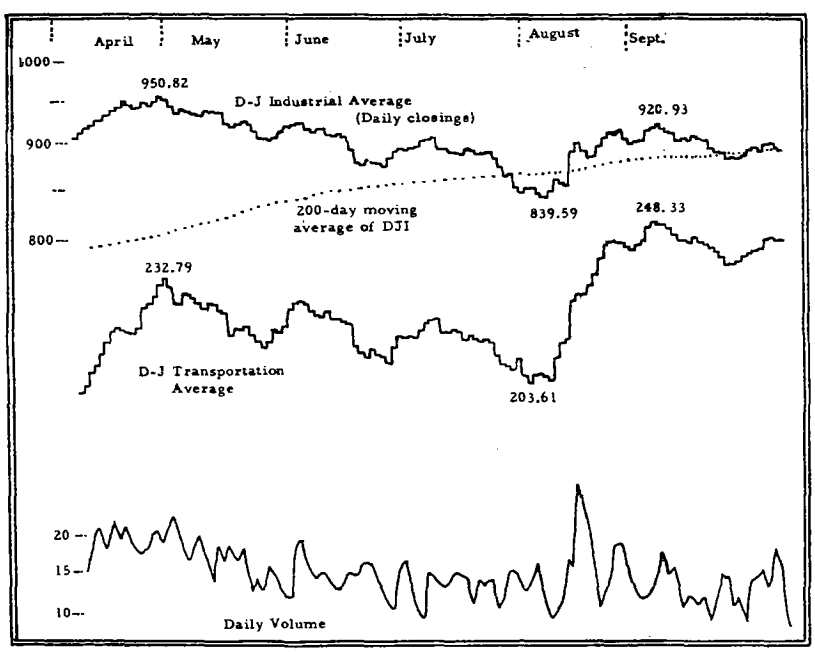
"One Headline is Worth 1,000 Words Dept." (From the Oct. 8 Wall Street Journal):

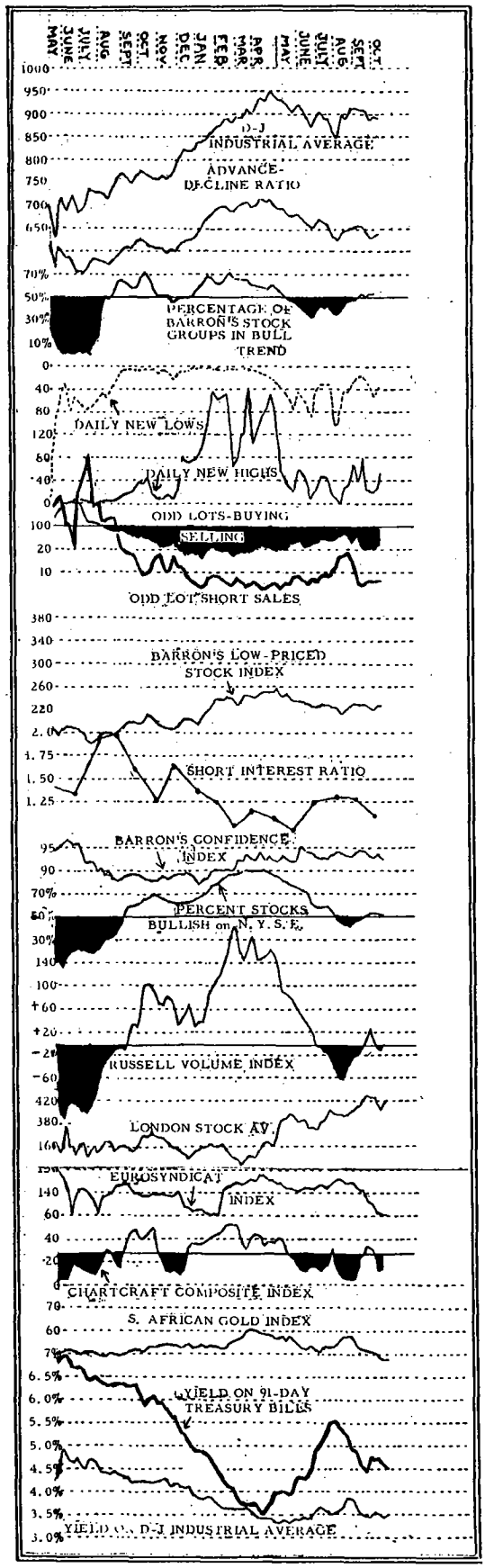
Foggy Phase 2

THE MARKET: From the standpoint of running an advisory service, this is one of the strangest periods I've seen since I started my business. I know that many people say, "Don't tell your clients your business." As far as I'm concerned, that is pure bunk, since I have nothing at all to hide. I'm in the business of providing information — all kinds, not hiding it. Well, the fact here is that subscriptions have been really excellent but surprisingly, new, short-term trial subscriptions are slow. I've never seen such a marked divergence. It's as if all my subscribers want to stay with me, serious investors are coming in with new subscriptions, but the general public, the people who buy the dollar trial subscriptions (which I advertise in Barron's and by direct mail) are becoming more and more disillusioned.

Frankly, I find this an ominous trend from the standpoint of Wall Street and those connected with the stock market. I have checked with many brokers over the past few weeks, and they seem to find the same trend operating. "If you don't do institutional business," they say (and how many brokers do?) "you're dead." The public is leaving Wall Street in droves. They haven't made any money on balance in a few years, and they want out. They're also getting squeezed by soaring living costs and high-priced services of all kinds. The public has been hurt badly in recent years, and if they have any cash left, they want to hang on to it.

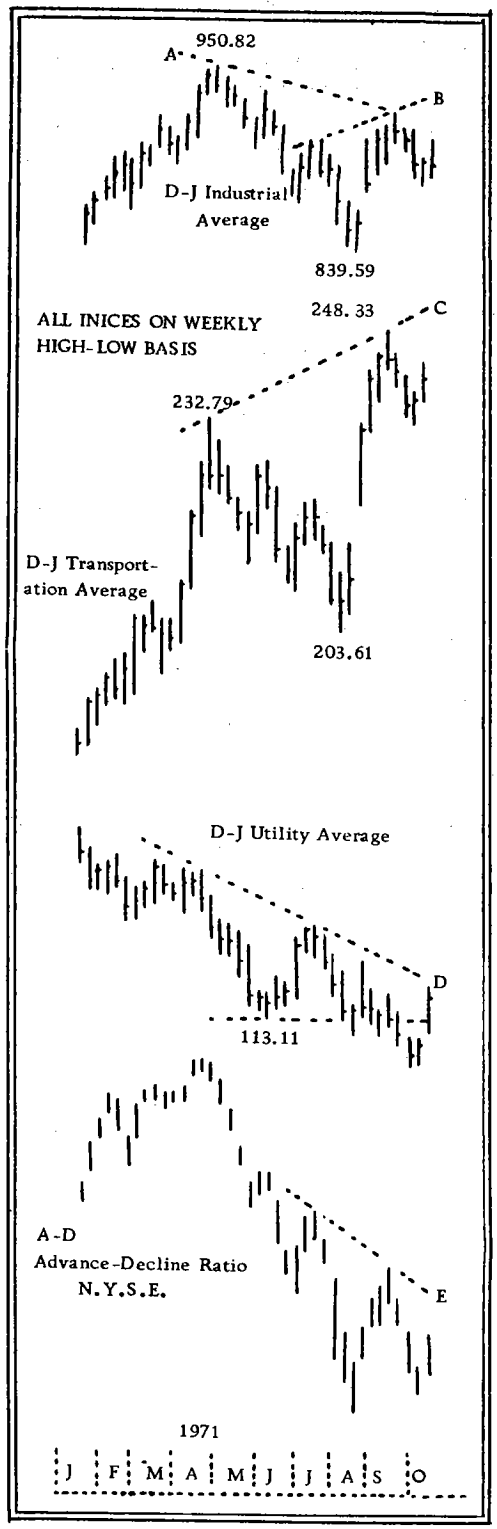
On page 2 I include charts of eight leading basic metal and natural resource (all boom or bust oriented) stock groups. They are the kinds of groups that surge during real economic booms and collapse during real depressions. Note that every one of these groups (they are all tabulated from Standard & Poor figures) are in bearish trends and below their 30-week moving averages





(dotted lines). These charts are courtesy of Indicator Chart Service, Palisades Park, N.J. 07650. My interpretation of these group charts is that there is no economic boom on the horizon. Rather, these sliding groups smack more of world recession, receding business, economic sluggishness.

As far as the market is concerned, the story continues much the same as it has been presented in the last two reports. The recent peaks of 920.93 recorded by Industrials on September 8 and 248.33 recorded for Transports on September 7 continue to stand. The market is still locked in the series of non-confirmations which I have documented on the page 2 chart. Note that since April, 1971, a non-confirmation has existed between Industrials and Transports (illustrated by the divergent trendlines A and C), with Industrials refusing to better their April peak of 950.82. Such a flagrant divergence would ordinarily be sufficient to place the market on suspicious technical grounds.

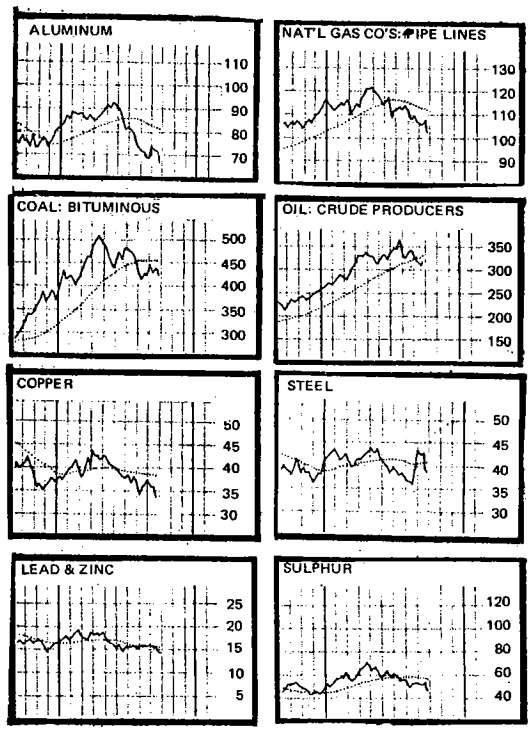


However, note also that since July, there has been a non-confirmation between the Industrials and the advance-decline ratio as illustrated by the divergent trendlines B and E. Thus, the A-D ratio has refused to better its July peak, even though Industrials during the September rally succeeded in pushing above their July peak of 903.40. Technically (and this is ironic) a new push by the Dow above the 920.93 September peak, if unconfirmed again by the A-D ratio, would merely make the situation that much more "toppy" and dangerous.

Finally, the Utility Average (which often shows lead characteristics) has been acting worse than any other segment, and recorded new lows for the year a few weeks ago.

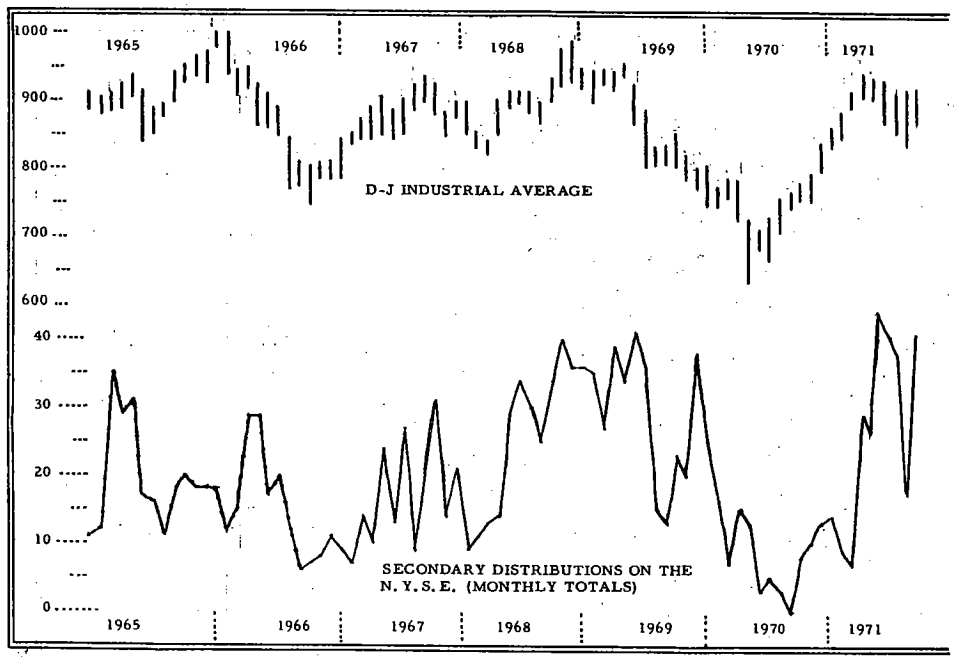
I am aware that the majority of economists, investment advisors and investment publications are bullish and look for a new "bull market" rise during the period ahead and into 1972. Those optimists who have turned mildly cautious over the past few weeks have done so strictly on a short-term basis. Many point to Mr. Nixon's promise that he will produce "a surprise a month", and such manipulations are supposed to keep the market on an upward course.

All I can say is that this primary bear market is also capable of producing a few surprises, and one of them is that since 1966 the D-J Industrial Average has never been able to better its 995.15 high. A second one (see last Letter, page 3) is that the Dow since 1966 has traced out a major series of declining tops and bottoms. I am afraid that the market may have bigger surprises ahead than anything President Nixon can bring out of Washington. Time will tell, but the current pattern of the indicators, as shown on the page 2 chart, allows for plenty of surprises, and the odds are that they will be in favor of the bear.



SECONDARIES: Secondary distributions have been discussed before as has my secondary index (see Letter 503). To repeat briefly, however, the secondary is one of the common methods used by big investors and institutions to distribute large blocks of stock. Many of these secondaries are "supported" during the period of distribution, and this means

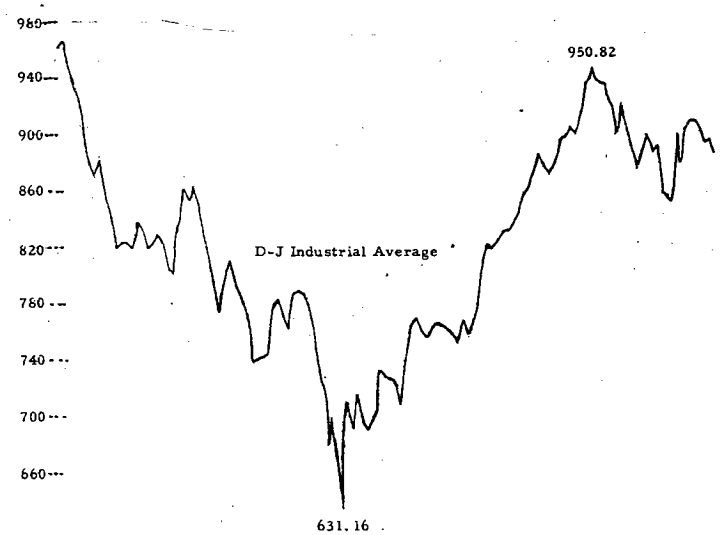
that the price is held up by the distributing organization so that the sheer weight of the offering will not depress the market for the stock. Obviously, secondary distributions are easiest to sell in frothy, high-volume markets, and a large or increasing number of secondary offerings is often a sign of an impending top.

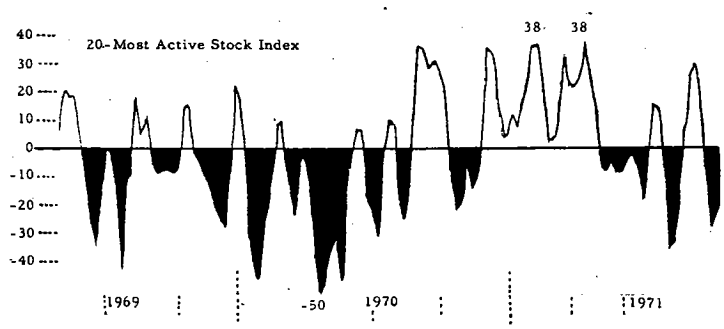


The accompanying chart shows monthly totals of secondary distributions. Note the large mass of secondaries which appeared during late-1968 and the first half of 1969. This occurred before and during the early stages of the 1969-70 collapse, and it constituted a beautiful series of danger signals.

Secondary distributions touched a low of 3 in May, 1970, and again in July. Clearly, nobody wanted to try distributing huge blocks amid the pessimism of the 1970 lows. But as the market climbed, secondary distributions got active again. In April, 1971, a record of 44 secondaries appeared. That proved to be the top of the market (so far) for 1971. Secondaries dropped to 18 during August, but last month (September) saw the secondary index rise to a lofty 41.

Thus it appears to me that large numbers of secondaries are waiting to come out on any show of strength in this market. This is characteristic of a market under distribution, with many big investors standing in line to get off their "wares" on any persistent signs of volume, enthusiasm or upside power.





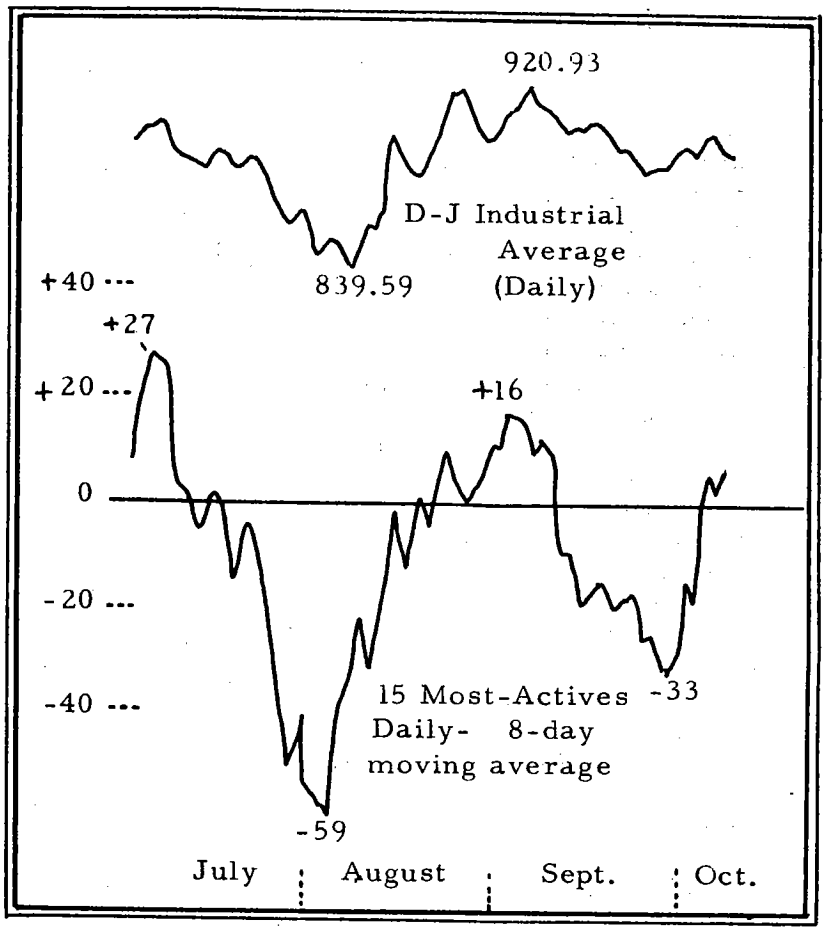
MOST ACTIVES: The preceding section covered one method of detecting distribution on the Exchange. Another method which I use for uncovering accumulation or distribution is the index of the most active stocks on the N.Y.S.E. Each week Barron's (and often your local Sunday newspaper) will publish a list of the 20 most active stocks on the N.Y.S.E. for the preceding week. This list is very important, and as a rule those 20 most active stocks will comprise about 15% of all the exchange volume for the week. The most actives show where the greatest activity has been centered, and the direction of this activity is often a clue as to the coming direction of the market.

To compute the most active index I simply tabulate the plurality of the most actives which advanced or declined each week. For instance, if 15 stocks rose and 5 declined, the plurality is a plus 10. The weekly figures are then

arranged on a 3-week moving average and charted as shown.

Note the almost constant minus (black areas) totals during 1969 and the early part of 1970. Obviously, the most active were persistently on the downside during this period of mass selling. The downside climax came with a minus 50 on the week of April 24. This climax appeared five weeks before the 631.16 (Dow Industrial) extreme low of May 26, 1970.

From that point on, the black areas began receding. By late 1970 the index figures started into the plus area. The plus figures continued strongly into 1971 with a peak reading of plus 38 being registered on the week ending February 12 and again during the week ending April 16. It was a warning signal when the April 16 reading (with the Dow at 940) did not better the February 12 reading (at which time the Dow was 888).



On April 28, 1971, the Dow closed at the high for the year of 950.82. The most active index dropped from the plus 38 of the previous week to a plus 24 on the week the Dow recorded its high. On the week ending May 3 the index dropped to the minus area. I think it is significant that of the 25 weeks since the April 28 Dow high, the index has been on the minus side (black area) during 17 weeks or 68% of the time. This suggests to me that there has been steady distribution on the N.Y.S.E. ever since the April, 1971, peak.

For the past three months I have been experimenting with a more sensitive gauge of the most actives, I include a graph of this second study, a study which I feel will interest subscribers. This is a daily computation of the 15-most active stocks on the N.Y.S.E., arranged in the form of an 8-day moving average. Surprisingly, the daily index shows an even weaker picture since July than does the weekly study. Note that the daily chart shows a peak of plus 27 in July, followed by a low of minus 59 in August, and then a rally to plus 16 on September 3 and again on the 7th. Thus, unlike the weekly-index, the daily index failed to better its July level during the September rally. The index tumbled towards the end of September, establishing a low of minus 33 on September 29. It will be interesting to see whether the period ahead will take the index above the September 3rd peak of plus 16 or below its September 29 low of minus 33.

Actually, the most interesting factor to me is that in the 56 trading days since July 15, the daily index has only been on the plus side on 15 days or around 25% of the time. In fact, the rally to the September 8 Dow peak of 920.93 produced a feeble high of only plus 16 on the daily index. Thus, judging from the daily index I would say that the market is under persistent distribution. I expect to do considerable more research on the daily most-active index and it is possible that this new index will prove far more accurate than the weekly index. All results will be reported on in these reports.

MONETARY SITUATION: Seldom has the world been beset with more pious words and fewer actual solutions to its monetary and economic problems than now. The aftermath of the IMF meeting can best be gauged by reading Editor Bob Bleiberg's brilliant article in the October 4 Barron's. "Actual— or public— agreement," wrote Bleiberg, "extended merely to the agenda and date for the next meeting of the Group of Ten, which now is scheduled for mid-November in Paris." More ominous is the fact that time is running against a "happy" settlement of the confrontation between the U.S. and its trading partners. For with international business at its current height, if agreement cannot be reached one wonders how agreement (particularly on revaluations) will be arrived at on a later date as the effects of the 10% U.S. surcharge take hold and as business slows across the face of the Free World.

As Mr. Bleiberg points out, in contrast to 1944 when the Bretton Woods agreements were concluded at a time when the world was on the edge of a huge bull market expansion, the current confrontations are occurring at a time when the world "may be on the brink of global recession or worse."

From this month's Bank Credit Analyst (edited by Donald Storey) comes another jarring comment: "On a longer-term basis, the risks of a slowly spreading deflation around the world, which would certainly involve trade and payments restrictions and controls, cannot be ignored. Those who argue that the U.S. can get along without the rest of the world should remember that the Smoot-Hawley Tariff, passed in 1930 for reasons similar to the recent U.S. surcharges, was associated with an almost immediate worsening of the U.S. depression and a virtual collapse of U.S. exports in the following few years."

Charles Stahl of Green's Commodity Market Comments puts it (if possible) even stronger in this week's mailing: "Stop the Dollar, the World Wants to Get Off. The U.S. insistence on allowing the uninhibited export of dollars may well precipitate the complete destruction of the capitalist world; it has already rocked our monetary system as well as the economic policies of many governments."

Friend Eliot Janeway (currently in Europe) writes in his latest report that "Unemployment in the U.S. has now exploded with the August figures from an official perplexity into an official climax, with worse still to come and coming fast." Regarding Europe, Janeway states that Europe "....knows that for the first time she is coming within range of competitive fire from Japan, just when her own economy is going bad."

Meanwhile, in the face of softening international business Treasury Secretary Connally is demanding a turnaround of $11 billion (lowered from $13 billion) in U.S. international payments. Obviously, such a turnaround would mean a comparable deterioration in the payment accounts of the U.S.'s trading partners— just at a time when their business is falling off and when profits are being squeezed. Perhaps the best commentary on the whole overseas picture is the fact that mighty Volkswagen has just changed presidents and faces the prospect of going into the red for the year.

Another sign of what is occurring is the current low on the Eurosyndicat Average of the 100 largest Common Market corporations (see right-hand page 1 chart for Eurosyndicat Index.) Here we see the Index flirting with a two-year low.

The fact is that the primary bear market is slowly, subtly but relentlessly beginning to take hold across the breadth of the Free World. I include a montage from three sources showing that unemployment, despite every kind of government manipulation and massive spending programs, simply will not recede. The unemployment also expands in the face of U.S. deficits and spending programs which literally piled up dollars like paper mountains in Europe and Japan — and wrecked the monetary system which had been in operation for a quarter of a century.

Canadian jobless rate not following directions

By Ronald Anderson
Special to The Christian Science Monitor

Toronto

Unemployment this year is showing a stubborn refusal to conform to the Canadian federal government's game plan. Instead of declining gradually through the second half of the year, as Finance Minister E. J. Benson had predicted it would, the seasonally adjusted unemployment rate in July remained at the first-half average of 6.3 percent of the labor force, and in August moved up to 6.5 percent.

Analysts here are doubtful that the level of unemployment will fall below 6 percent this winter, in view of the dampening effec of the U.S. import surcharge on Canadia exports of manufactured goods.

In addition, competition from offsho imports is becoming mor
General Motors of Can ample, announced last to lay off about 7 percer during the winter.

Competition from Jap domestic market was reason for the impendin affect 1,500 to 2,000 worl Motors plants in Ontario.

voluntary price restraint pro- Prices and Incomes

'High Unemployment' Cities Hit 64, a 10-Year Record

By a WALL STREET JOURNAL *Staff Reporter*

WASHINGTON — The Labor Department added San Francisco-Oakland and Gary-Hammond-East Chicago, Ind., to its list of major metropolitan areas with unemployment rates of 6%, or more.

This raises the number of big-city areas with "substantial" unemployment to 64, the highest in 10 years, the department said. In September 1970, there were just 35 such areas on the list.

The report said the increase in joblessness in the San Francisco-Oakland area was due in part to the current dock strike. While strikers themselves aren't included in the figures, the walkout indirectly has cut employment in the water-transp tion industry and t

As Britain's jobless total approaches the million mark Malcolm Stuart reports from Peterborough where the number of dole queue teenagers — some without work since leaving school — highlights a new and growing problem.

Meanwhile, the central problems remain, with or without a new monetary system. There exists approximately $50 billion in claims (measured originally in gold) which the U.S. owes to its trading partners. At present, those claims are still expanding, and if the trend is to be reversed then the U.S. trading partners must give up what the U.S. wins.

But aside from the still deteriorating U.S. payments position, what is the world to do with the $50 billion in claims against the U.S.? As C.V. Myers states in his latest Myers Finance Review, "Debts always have to be liquidated, (a) paid back, or (b) repudiated." This presents a mighty problem for the U.S., and to my mind there are only two possible answers. Bankruptcy (repudiation) which is unthinkable and would throw the world into a cataclysmic depression. Or a long-range policy of repayment. Repayments of debts necessarily implies a massive turnaround in the U.S. payments picture, and this is the thesis that Mr. Connally is espousing. But note that Mr. Connally is not presenting the turnaround as an exercise in U.S. sacrifice, increased productivity and ingenuity. No, he is presenting the proposed $11 billion turnaround as a need for sacrifices on the part of our trading partners.

What he is saying is, "Look, Japan, Germany, France, Britain, Switzerland and all you other nations, we are being outproduced by you people. Furthermore, our expenses are sky-high and they're built-in andwe can't lower them significantly. So what we

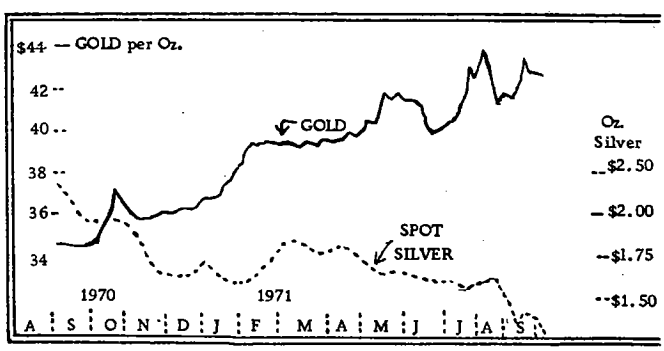
want you people to do before we lower our surcharge is to revalue your currencies and make yourselves less competitive. Then, with re-valuation "handicaps" on the part of our trading partners, we'll be able to cut our imports, raise our exports and reverse our payments picture."

Confronted by this kind of reasoning, what can Europe and Japan be thinking? They are thinking that they want to get rid of the dollar as a reserve currency as quickly as possible! They are thinking that trading with the U.S. and piling up dollars is another way of being in the fiat-paper business, and they've had enough of that. They are wondering how they are going to get anything for the $50 billion which the U.S. now owes them. Their only true, legitimate hope would be a tripling or a quadrupling of gold, and then a gradual policy of drawing off their claims from what is left of a re-valued U.S. gold stockpile. Of course there is always the chance that the U.S. might get competitive again, build up reserves, and then be able to pay off in either gold or accumulated hard currencies. But as of now, that prospect flies in the face of all the trends — it is a dream.

So it looks like a long, hard winter for the trading partners, and as far as their claims are concerned, it appears that they might as well try to get "blood from a stone". But if one can't get blood from a stone, the best policy to pursue is to stop playing with stones. Thus, the once mighty U.S. dollar (the stone), the dollar that used to be as good as gold, has gone down to ignonimous defeat, and the implications of that fall, in my opinion, have yet to be felt in the world economies. The fall of the dollar, it must be remembered, is a symbol. It is a symbol of the fall of U.S. economic integrity and the collapse of U.S. competitiveness and productivity.

Could the U.S. be competitive again? Could the dollar rise again? Of course, but that would mean sacrifice, "blood, sweat and tears". And the U.S. is not about to have any of that. But what one rejects voluntarily, one often faces on an involuntary basis. And that's what bear markets are all about.

GOLD, SILVER: Below is our regular gold and silver price chart. The dollar price of gold is still in a bullish trend, but if silver, at around $1.29 spot, gets any weaker, I'm going to have to redraw my chart.



I thought this column from the Oct. 2 New York Times was interesting enough to be included below.

By ROBERT METZ

One winter day in 1964, William H. Tehan was driving through the Catskills when he rounded a curve and skidded on a sheet of ice into the opposite lane. In a fraction of a second his car hit another car head-on and he hurtled through the windshield.

"In the moment before this happened—it seemed like an hour—I kept thinking this can't be happening to me, we won't collide."

He still has a long, thin scar over his right eye and almost died from loss of blood before the ambulance came.

The Amherst-educated Mr. Tehan, 43 years old, is an analyst for P. R. Herzig & Co., a Big Board member firm specializing in research in international monetary affairs.

Mr. Tehan says he thinks the world is presently headed for a monetary disaster much greater than that experienced in the nineteen-thirties but feels we are as unwilling to accept this as he was the inevitability of his collision.

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Basically he described the problem as one of liquidity —too much debt. By that he means the world's central banks now hold $28-billion in United States currency.

"This is a dramatic change from just 18 months ago, when the central banks held just $7-billion," Mr. Tehan said.

"This massive rise in dollar balances is basically what caused President Nixon to suspend the convertibility of the dollar into gold. Remember there is only $10.5-billion in gold reserves in the United States.

"It's not generally known, but two major central banks presented dollar claims to the United States of $3.5-billion for conversion into gold less than a week before the President announced his new economic plan. We can assume this helped trigger his remarks."

But in Mr. Tehan's view this phase of the long dollar crisis, which he said began in 1958, started in January, 1970, as dollar balances began to accumulate at a very rapid rate in central banks.

By mid-August, when Mr. Nixon spoke, central-bank dollar claims exceeded the United States gold supply by 2.3 times.

"But when he suspended the convertibility of the dollar he shattered the basic structure of the world monetary system established at Bretton Woods in 1944," Mr. Tehan said. "As a result, the entire monetary system is now floating, with the various currencies seeking new levels day to day.

"With floating rates, major world corporations involved in international trade will be unable to make long-term commitments. For example, a major distributor agrees to buy $1-million worth of Japanese cameras in six months. The fluctuation in the currency rate in six months could be enough to wipe out the potential profit in the transaction.

"The Bretton Woods agreement emerged from the chaotic situation of world trade in the nineteen-thirties, which was due to floating currencies."

Mr. Tehan added that it was inevitable that chaos would occur again. "We are in a world recession now and I believe this current floating currency situation will turn it into a world depression," he said.

"Nations with strong currencies, primarily Germany and Japan, will experience serious deterioration in their international balance of payments in the coming 12 months. This in turn will weaken their currencies. Holders of Deutsche marks and yen will sell. The two central banks will then sell the United States Treasury bills to raise the dollars needed to buy the marks and yen.

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"This sale of bills by foreign central banks will come when the Treasury is attempting to finance an estimated $35-billion deficit for the fiscal year ended June, 1972.

"Interest rates on bills must therefore rise and the world interest-rate structure will rise with it.

"The business recovery here will be aborted, and interest rates will be so high that there will be significant corporate bankruptcies in major world trading nations."

This spelled a depression in Mr. Tehan's book and he offered these suggestions:

"The best thing for the investor to do is have a significant percentage of his assets in high grade gold-mining investments and the balance in cash. More aggressive accounts might even consider going short in silver mining stocks, aluminum stocks, some copper stocks, Xerox, I.B.M., and all the high-price earnings ratio, low-yield stocks."